

that the compensation taken into account for any employee in determining plan allocations or benefit accruals for any plan year is limited to the annual compensation limit. For purposes of this rule, allocations and benefit accruals under a plan include all benefits provided under the plan, including ancillary benefits.

(2) *Plan-year-by-plan-year requirement.* For purposes of this paragraph (b), the limit in effect for the current plan year applies only to the compensation for that year that is taken into account in determining plan allocations or benefit accruals for the year. The compensation for any prior plan year taken into account in determining an employee's allocations or benefit accruals for the current plan year is subject to the applicable annual compensation limit in effect for that prior year. Thus, increases in the annual compensation limit apply only to compensation taken into account for the plan year in which the increase is effective. In addition, if compensation for any plan year beginning prior to the OBRA '93 effective date is used for determining allocations or benefit accruals in a plan year beginning on or after the OBRA '93 effective date, then the annual compensation limit for that prior year is the annual compensation limit in effect for the first plan year beginning on or after the OBRA '93 effective date (generally \$150,000).

(3) *Application of limit to a plan year—*  
(i) *In general.* For purposes of applying this paragraph (b), the annual compensation limit is applied to the compensation for the plan year on which allocations or benefit accruals are based.

(ii) *Compensation for the plan year.* If a plan determines compensation used in determining allocations or benefit accruals for a plan year based on compensation for the plan year, then the annual compensation limit that applies to the compensation for the plan year is the limit in effect for the calendar year in which the plan year begins. Alternatively, if a plan determines compensation used in determining allocations or benefit accruals for the plan year on the basis of compensation for a 12-consecutive-month period, or periods, ending no later than the last day

of the plan year, then the annual compensation limit applies to compensation for each of those periods based on the annual compensation limit in effect for the respective calendar year in which each 12-month period begins.

(iii) *Compensation for a period of less than 12 months—*(A) *Proration required.* If compensation for a period of less than 12 months is used for a plan year, then the otherwise applicable annual compensation limit is reduced in the same proportion as the reduction in the 12-month period. For example, if a defined benefit plan provides that the accrual for each month in a plan year is separately determined based on the compensation for that month and the plan year accrual is the sum of the accruals for all months, then the annual compensation limit for each month is  $\frac{1}{12}$ th of the annual compensation limit for the plan year. In addition, if the period for determining compensation used in calculating an employee's allocation or accrual for a plan year is a short plan year (i.e., shorter than 12 months), the annual compensation limit is an amount equal to the otherwise applicable annual compensation limit multiplied by a fraction, the numerator of which is the number of months in the short plan year, and the denominator of which is 12.

(B) *No proration required for participation for less than a full plan year.* Notwithstanding paragraph (b)(3)(iii)(A) of this section, a plan is not treated as using compensation for less than 12 months for a plan year merely because the plan formula provides that the allocation or accrual for each employee is based on compensation for the portion of the plan year during which the employee is a participant in the plan. In addition, no proration is required merely because an employee is covered under a plan for less than a full plan year, provided that allocations or benefit accruals are otherwise determined using compensation for a period of at least 12 months. Finally, notwithstanding paragraph (b)(3)(iii)(A) of this section, no proration is required merely because the amount of elective contributions (within the meaning of § 1.401(k)-1(g)(3)), matching contributions (within the meaning of § 1.401(m)-1(f)(12)), or employee contributions

(within the meaning of § 1.401(m)-1(f)(6)) that is contributed for each pay period during a plan year is determined separately using compensation for that pay period.

(4) *Limits on multiple employer and multiemployer plans.* For purposes of this paragraph (b), in the case of a plan described in section 413(c) or 414(f) (a plan maintained by more than one employer), the annual compensation limit applies separately with respect to the compensation of an employee from each employer maintaining the plan instead of applying to the employee's total compensation from all employers maintaining the plan.

(5) *Family aggregation.* [Reserved]

(6) *Examples.* The following examples illustrate the rules in this paragraph (b).

*Example 1.* Plan X is a defined benefit plan with a calendar year plan year and bases benefits on the average of an employee's high 3 consecutive years' compensation. The OBRA '93 effective date for Plan X is January 1, 1994. Employee A's high 3 consecutive years' compensation prior to the application of the annual compensation limits is \$160,000 (1994), \$155,000 (1993), and \$135,000 (1992). To satisfy this paragraph (b), Plan X cannot base plan benefits for Employee A in 1994 on compensation in excess of \$145,000 (the average of \$150,000 (A's 1994 compensation capped by the annual compensation limit), \$150,000 (A's 1993 compensation capped by the \$150,000 annual compensation limit applicable to all years before 1994), and \$135,000 (A's 1992 compensation capped by the \$150,000 annual compensation limit applicable to all years before 1994)). For purposes of determining the 1994 accrual, each year (1994, 1993, and 1992), not the average of the 3 years, is subject to the 1994 annual compensation limit of \$150,000.

*Example 2.* Assume the same facts as Example 1, except that Employee A's high 3 consecutive years' compensation prior to the application of the limits is \$185,000 (1997), \$175,000 (1996), and \$165,000 (1995). Assume that the annual compensation limit is first adjusted to \$160,000 for plan years beginning on or after January 1, 1997. Plan X cannot base plan benefits for Employee A in 1997 on compensation in excess of \$153,333 (the average of \$160,000 (A's 1997 compensation capped by the 1997 limit), \$150,000 (A's 1996 compensation capped by the 1996 limit), and \$150,000 (A's 1995 compensation capped by the 1995 limit)).

*Example 3.* Plan Y is a defined benefit plan that bases benefits on an employee's high consecutive 36 months of compensation ending within the plan year. Employee B's high

36 months are the period September 1995 to August 1998, in which Employee B earned \$50,000 in each month. Assume that the annual compensation limit is first adjusted to \$160,000 for plan years beginning on or after January 1, 1997. The annual compensation limit is \$150,000, \$150,000, and \$160,000 in 1995, 1996, and 1997, respectively. To satisfy this paragraph (b), Plan Y cannot base Employee B's plan benefits for the 1998 plan year on compensation in excess of \$153,333. This amount is determined by applying the applicable annual compensation limit to compensation for each of the three 12-consecutive-month periods. The September 1995 to August 1996 period is capped by the annual compensation limit of \$150,000 for 1995; the September 1996 to August 1997 period is capped by the annual compensation limit of \$150,000 for 1996; and the September 1997 to August 1998 period is capped by the annual compensation limit of \$160,000 for 1997. The average of these capped amounts is the annual compensation limit applicable in determining benefits for the 1998 year.

*Example 4.* (a) Employer P is a partnership. Employer P maintains Plan Z, a profit-sharing plan that provides for an annual allocation of employer contributions of 15 percent of plan year compensation for employees other than self-employed individuals, and 13.0435 percent of plan year compensation for self-employed individuals. The plan year of Plan Z is the calendar year. The OBRA '93 effective date for Plan Z is January 1, 1994. In order to satisfy section 401(a)(17), as amended by OBRA '93, the plan provides that, beginning with the 1994 plan year, the plan year compensation used in determining the allocation of employer contributions for each employee may not exceed the annual limit in effect for the plan year under OBRA '93. Plan Z defines compensation for self-employed individuals (employees within the meaning of section 401(c)(1)) as the self-employed individual's net profit from self-employment attributable to Employer P minus the amount of the self-employed individual's deduction under section 164(f) for one-half of self-employment taxes. Plan Z defines compensation for all other employees as wages within the meaning of section 3401(a). Employee C and Employee D are partners of Employer P and thus are self-employed individuals. Neither Employee C nor Employee D owns an interest in any other business or is a common-law employee in any business. For the 1994 calendar year, Employee C has net profit from self-employment of \$80,000, and Employee D has net profit from self-employment of \$175,000. The deduction for Employee C under section 164(f) for one-half of self-employment taxes is \$4,828. The deduction for Employee D under section 164(f) for one-half of self-employment taxes is \$6,101.

(b) The plan year compensation under the plan formula for Employee C is \$75,172